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June 20, 2018

South Carolina Office of Regulatory Staff
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RE: DOCKET NO. 2017-305-E – Interpretation Letter of Baker Tilly's June 12, 2018 Report on the Potential Financial Ramifications on SCE&G of the Eight Scenarios in Commission Order No. 2018-102

To the Office of Regulatory Staff:

In connection with the request of ORS for Baker Tilly to prepare a letter that interprets our report issued June 12, 2018, this document provides an interpretation of that report on the potential financial ramifications that each of the eight scenarios in Commission Order No. 2018-102 could have on SCE&G.

Our summary interpretation is presented in this letter.

Summary of interpretations of each scenario

The following is a summary of our interpretation of each scenario. Our interpretations are computed on a pre-tax basis. Based on our interpretation of the scenarios, SCE&G will generate positive cash flows from operations at various levels for all of the scenarios except for Scenario 6.

Table 1 – Executive Summary of the Eight Scenarios

#	Description	Interpretation
1	Suspend annual collection of Revised Rates and do not credit ratepayers \$2 billion of previously collected revenues	<p>Under Scenario 1, beginning in ProForma 2018, SCE&G's annual cash flows from operations would be roughly \$400 million lower than SCE&G's 2017 base year. The reduction in revenue will still result in positive operating cash flow to SCE&G over the period we reviewed (ProForma 2018 – 2021).</p> <p>Additionally, SCE&G would record an impairment charge for the outstanding CWIP balance associated with the V.C. Summer project (which is now recorded as a deferred debit). Thus, total equity of SCE&G will also be reduced by the write-off amount of \$3.9 billion.</p> <p>Strategies that SCE&G could implement to offset the impact of this cash flow gap might include:</p> <ul style="list-style-type: none"> > Temporarily reduce or eliminate dividend payments (which were \$344 million in 2017) > Reduce annual capital improvements or adjust long-term capital project planning to meet the expected reduced cash flows > Reduce operating expenses

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		Based on our experience, reducing operating expenses in a utility would increase cash flows but would not yield significant cash flow savings to close the annual \$400 million cash flow gap, so the likelier options would be to reduce or eliminate dividends and temporarily reduce capital improvements or adjust long-term capital project planning to meet the expected reduced cash flows.
2	Suspend annual collection of Revised Rates and credit ratepayers \$2 billion of previously collected revenues over a four-year term	<p>Under Scenario 2, annual cash flows from operations would be \$918 million lower than SCE&G's 2017 base year. SCE&G spends approximately \$960 million annually for capital improvements and dividend payments. While dividends and capital improvement costs can be reduced, SCE&G annual debt principal and interest payments of \$987 million are a fixed cost, as those payments must be made to bondholders unless the terms of the bond indentures that requires those payments are restructured.</p> <p>Generally, rating agencies use a weighted average analysis of up to 50 financial ratios to evaluate the financial health of an organization. In our experience, the ratio of Long-term Debt/Total Capitalization is one ratio that is weighted heavily in the ratings agencies' evaluation which simply compares total outstanding long term debt to the company's total capitalization. For example under this scenario, Moody's would rank SCE&G's ProForma 2021 Long-Term Debt/Total Capitalization ratio of 72% in the category of Caa. This rating would be defined as "speculative to near default"¹.</p> <p>It is our interpretation of Scenario 2 that even if SCE&G reduces or eliminates shareholder dividends and substantially reduces capital improvements, its ability to fully pay debt principal and interest payments without restructuring its current debt load or increasing rates would be severely compromised.</p>
3	Assuming no CWIP recovery and no credit to ratepayers of \$2 billion of previously collected revenues	If no "CWIP recovery" is allowed, the assets become impaired identical to Scenario 1. When assuming no CWIP recover, we simply interpreted this, as SCE&G would not be able to recover any additional Revised Rates, which makes this Scenario identical to Scenario 1.
4	Assuming no CWIP recovery and a credit to ratepayers of \$2 billion of previously collected revenues over four years	<p>If no "CWIP recovery" is allowed and a credit to ratepayers is refunded, the assets become impaired identical to Scenario 2. When assuming no CWIP recover, we simply interpreted this, as SCE&G would not be able to recover any additional Revised Rates, which makes this Scenario identical to Scenario 2.</p> <p>From an overall impact perspective, we feel that Scenario 2 and 4 create the 2nd greatest financial hardship to SCE&G on a pretax basis based on the Scenarios reviewed.</p>

¹ Moody's 2017 publication – *Regulated Electric and Gas Industry Rating Methodology* - https://www.moodys.com/researchdocumentcontentpage.aspx?docid=PBC_1072530

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5	Assuming partial recovery of CWIP – Disallow CWIP back to each Revised Rates Date and no credit to ratepayers of \$2 billion of previously collected revenues	<p>This scenario is an analysis of what the impact would be on SCE&G in removing the BLRA rate increases one by one from the most recent to the oldest. Since the BLRA Revised Rates provide the revenue stream for SCE&G to recover the Carrying Costs of construction of V.C. Summer Units 2 & 3 and a Rate of Return on the construction costs, as each BLRA rate increase is removed, a corresponding impairment of the V.C. Summer construction costs occurs and the cumulative effect of the reduction in rates and the reduction in CWIP recovery is shown.</p> <p>Scenario 5 results in progressively larger operating losses. This is due to the need for SCE&G to record an impairment charge for each incremental disallowance of CWIP recovery as an order is removed from the analysis. Impairment charges are a non-cash charge and do not impact cash flows. Construction costs are not recorded as operating expenses and do not impact cash flows from operations.</p> <p>Cash flows from operations also progressively decrease as each order is removed and rates are reduced. The reduction in cash flows from operations under the removal of each order is the incremental increase in BLRA rates approved in that order. In other words, by the time the last order (Order 2009-104(A)) is removed from the analysis, the entirety of BLRA Revised Rates has been removed. This amount is \$445 million.</p> <p>Under Scenario 5, SCE&G's ratio of Long-term Debt/Total Capitalization remains in the speculative category. Also, under Scenario 5, beginning with the removal of Order 2011-738, annual cash flows from operations would be \$400 million lower than SCE&G's 2017 level of capital improvements and forecasted 2018 debt principal and interest payments. Strategies that SCE&G could implement to close this cash flow gap could include:</p> <ul style="list-style-type: none"> > Reduce or eliminate dividend payments (which were \$314 million in 2017) > Reduce annual capital improvements or adjust long-term capital project planning to meet the expected reduced cash flows > Reduce operating expenses <p>The likelier options would be to reduce or eliminate dividends and reduce capital improvements or adjust long-term capital project planning to meet the expected reduced cash flows. Employing these measures may allow the utility to weather the outcome of Scenario 5.</p>
6	Assuming partial recovery of CWIP – Disallow CWIP back to each Revised Rates Date and a credit to ratepayers of \$2 billion of previously collected revenues	<p>Under Scenario 6, SCE&G's ratio of Long-term Debt/Total Capitalization falls into near default category when Orders 2016-758, 2015-712, 2014-785, 2013-680(A) and 2012-761 are disallowed. SCE&G would also have significant cash flow shortfalls starting with the disallowance of Order 2015-712, with its cash shortfall reaching \$2 billion.</p> <p>It is our interpretation that if Order 2015-712 would be disallowed, that even if SCE&G reduces or eliminates shareholder dividends and substantially reduces capital improvements, its ability to fully pay debt principal and interest payments without restructuring its current debt load or increasing rates would not be possible.</p> <p>The scenario appears to provide the largest financial hardship to SCE&G.</p>

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7	Assuming full recovery of CWIP and no credit to ratepayers of \$2 billion of previously collected revenues	<p>Scenario 7 provides cash flows from operations of \$1.6 billion each year, which is nearly equivalent to its 2017 level of capital improvements and forecasted 2018 debt principal and interest payments.</p> <p>This scenario represents the most favorable financial impact for SCE&G and it is the current status quo, i.e. collection of the \$37 million per month of revenues authorized under the BLRA and a continued recovery of CWIP costs.</p>
8	Assuming full recovery of CWIP and a credit to ratepayers of \$2 billion of previously collected revenues over four years	<p>Annual cash flows from operations would be approximately \$500 million lower than SCE&G's 2017 base year. After the refund period (4 years), annual cash flows from operations would increase by \$445 million, providing what would appear to be adequate cash flows for capital improvements and bond principal and interest payments.</p> <p>Strategies that SCE&G could implement during the refund period to close this cash flow gap and better match cash flows from operations to the need for capital improvements and debt principal and interest payments include:</p> <ul style="list-style-type: none"> > Reduce or eliminate dividend payments > Reduce capital improvements or delay certain projects until after the refund period > Reduce operating expenses <p>Earnings and equity would be reduced significantly during the refund period. This would most likely impact funding available for capital improvements and reduce the ability to pay dividends to shareholders.</p>

Should you have any questions, we would be happy to discuss them with you. Do not hesitate to contact me at russ.hissom@bakertilly.com or at 608 240 2361.

We appreciate the opportunity to serve you.

Thank you.

Very truly yours,

BAKER TILLY VIRCHOW KRAUSE, LLP



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